**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

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| In the Matter of the Protest of<br><br>[Redacted],<br><br>Petitioner. | ) | DOCKET NO. 20363<br><br>DECISION |

[Redacted] (petitioner) protests the Notice of Deficiency Determination issued by the staff of the Idaho State Tax Commission (Commission) dated May 9, 2007, asserting additional Idaho income tax, penalty, and interest for 2001 in the total amount of $36,840.

The only issue in this docket is whether the disposition of property by the petitioner in 2001 qualified as a like-kind exchange pursuant to Internal Revenue Code § 1031.

BACKGROUND

[Redacted] have owned a particular parcel of real property in the [Redacted] area since at least some time in the 1980s. It appears the property was their personal residence until 1984 when they moved to another state. During 2001, the petitioner was not a resident of Idaho. On August 1, 2001, the petitioner disposed of residential property. He did not file an Idaho income tax return for 2001.

The staff of the Commission corresponded with [Redacted] inquiring as to why the sale of real property had not been reported to the state of Idaho. He responded that it had been disposed of through an exchange pursuant to Internal Revenue Code § 1031 and that no gain was reportable.

[Redacted] indicated that he and his wife had moved out of Idaho in 1984 and had not been Idaho residents since that time[1] and that they had not "received any income nor [sic] gain from/in Idaho otherwise since." A CPA was retained by the petitioner who related that since the petitioner

[1] Letter from [Redacted].

felt that the transaction was not taxable, he had failed to provide the information to his income tax return preparer. The CPA related that she had since completed the federal Form 8824 and that the transaction was a non-taxable event with deferred gain.[2] On July 11, 2007, [Redacted] submitted a different federal Form 8824 reflecting recognized gain in the amount of $21,972. It appears that no federal Form 8824 was filed with the petitioner's federal income tax return.

[Redacted] was repeatedly asked about the business use of the subject property [Redacted] addressed the issue,[3] in part, as follows:

> So I don't confuse any of the new issues that have apparently arisen in your abovementioned [sic] letters, I'll respond exclusively and directly to each, as follows below:
>
> To your letter of March 8:
>
> 1.) First sentence (a quote); "Since you (we) have classified this transaction as a business property, it must have been rented or leased to another individual."
>
> a. We have not ever "classified" either "this transaction" nor any of the properties involved as "business property(ies)." We have no idea nor record of how you/your office would have made this determination? A vacation home/investment property at [Redacted] was exchanged for a vacation home lot/investment property at [Redacted]. No "business properties" have ever been involved and we have never "classified" any as such.
>
> b. Neither properties have been rented nor leased to anyone, nor to nor through any agency or organization under our ownership(s).

[Redacted] responded,[4] in part, as follows:

> First of all, there is a question as to the ability for these assets to qualify for exchange. The properties were not "business properties". There is no place in the regulations which require a property to be a "business property" for a 1030 [sic] exchange. The properties were investment properties. There is no trail of income or expenses tied to these properties. They were merely properties held for investment purposes.

[2] Letter from [Redacted]. The letter bore no date, but was received by the Tax Commission staff on January 22, 2007.
[3] Letter to [Redacted]
[4] Letter to [Redacted]

[Redacted] again addressed the issue,[5] in part, as follows:

> There are hundreds of properties in and around [Redacted] and other resort areas as well, both houses and condominiums, that are used similarly, being owned primarily as investment properties and used occasionally as vacation homes or rooms, and then exchanged, quite according to the rules, under IRS code 1031.
>
> You, your office and I and any tax accountant or attorney know full-well that investment properties like ours, used occasionally or not, rented or not, and ours were not rented by choice, do qualify perfectly for 1031 like-kind exchange(s). (Underlining in original.)

[Redacted] changed representatives. While the prior representative, [Redacted] had contended that there was taxable "boot" received by the petitioner in the amount of $21,972, the next representative, [Redacted] contended that there was no taxable "boot." While [Redacted] submitted a detailed computation in support of her conclusion, [Redacted] has submitted no support for his conclusion.

DISCUSSION

It appears that the petitioner did not show the expenses related to the property in question as deductions on his tax returns. Instead, the expenses were treated as a payment for a second home. There is no indication in the returns that the property was to be treated other than as a residence. Several references were made to the use of the property either by [Redacted] family or by close friends. However, nothing was presented to indicate that the property was, at any time, rented for fair rental value. The petitioner contends that the property was held as investment property, and it would appear that one motive for holding the property was for just such a purpose. However, the taxpayer has the burden of showing that the *primary purpose* of holding the property was for investment. Montgomery v. Commissioner, T.C. Memo 1997-279. The Tax Court, in addressing this issue stated:

[5] Letter to[Redacted]

Petitioners point to their interest in the appreciation potential of the [Redacted] properties, both before and after acquisition, and argue: "If investment intent is one motive for holding * * * property, it is held for investment for purposes of Section 1031." Petitioners' argument, if carried to its logical extreme, is that the existence of any investment motive in holding a personal residence, no matter how minor a factor in the overall decision to acquire and hold (or simply to hold) the property before its inclusion in an exchange of properties, will render it "property * * * held for investment" with any gain on the exchange eligible for nonrecognition treatment under section 1031. Petitioners are mistaken. It is a taxpayer's *primary* purpose in holding the properties that counts. Montgomery v. Commissioner, T. C. Memo 1997-279 ("section 1031 requires that both the property transferred and the property received in a like-kind exchange be held primarily for productive use in a trade or business, or for investment."), affd. in part and revd. in part on another issue without published opinion 300 F.3d 866 (10th Cir.1999). Indeed, in Starker v. United States, 602 F.2d 1341, 1350-1351 (9th Cir.1979), the U.S. Court of Appeals for the Ninth Circuit recognized the longstanding rule that the exclusive use of property by the owner as his residence contradicts any claim by him that the property is held for investment. The court applied the rule specifically to section 1031 exchanges. The court said:

It has long been the rule that use of property solely as a personal residence is antithetical to its being held for investment. Losses on the sale or exchange of such property cannot be deducted for this reason, despite the general rule that losses from transactions involving * * * investment properties are deductible. A similar rule must obtain in construing the term "held for investment" in section 1031. * * * [ *Id.;* citations omitted.]

This and other courts have reached the same conclusion in the context of deciding whether expenses incurred with respect to a personal residence are deductible under section 212(2) as "expenses paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income". Property held for investment is property held for the production of income within the meaning of section 212. See Newcombe v. Commissioner, 54 T.C. 1298, 1302 (1970) (an expense deduction is justified under section 212(2) only if the property to which it relates "is 'held for investment,' i.e., for the production of income"); sec. 1.212-1(b), Income Tax Regs. Thus, both section 1031 and section 212(2) involve the same factual inquiry whether the property in question was held for investment.

As a preliminary matter, we accept as a fact that petitioners hoped that both the [Redacted] properties would appreciate. However, the mere hope or expectation that property may be sold at a gain cannot establish an investment intent if the taxpayer uses the property as a residence. See

Jasionowski v. Commissioner, 66 T.C. 312, 323 (1976) ("if the anticipation of eventually selling the house at a profit were in itself sufficient to establish that the property was held with a profit-making intent, rare indeed would be the homeowner who purchased a home several years ago who could not make the same claim"). Moreover, a taxpayer cannot escape the residential status of property merely by moving out. In Newcombe v. Commissioner, *supra*, the taxpayers listed their former residence for sale on or about the day they moved out, December 1, 1965. They sold the property at a loss on February 1, 1967. The issue in Newcombe relevant to this case was whether, during 1966, the property was held for the production of income (i.e., for investment) so as to entitle the taxpayers to deductions for maintenance expenses under section 212(2). In denying those deductions we stated:

> The taxpayer must * * * be seeking to realize a profit representing postconversion appreciation in the market value of the property. Clearly, where the profit represents only the appreciation which took place during the period of occupancy as a personal residence, it cannot be said that the property was "held for the production of income." * * * [ *Id.* at 1302.]

We added: "The placing of the property on the market for immediate sale, at or shortly after * * * its abandonment as a residence, will ordinarily be strong evidence that a taxpayer is not holding the property for postconversion appreciation in value." *Id*

This Court has frequently applied the reasoning of one or both of Jasionowski and Newcombe in rejecting taxpayer arguments that because a second or vacation home was held for appreciation (i.e., investment) the taxpayer was entitled to a deduction, undersection 212(2), for expenses incurred to maintain or improve the property. See, e.g., Ray v. Commissioner, T.C. Memo.1989-628; Houle v. Commissioner, T.C. Memo.1985-389; Gettler v. Commissioner, T.C. Memo.1975-87. In both *Ray* and *Houle* we denied the deductions on the ground that the taxpayers treated the houses as a "second home" (Ray) ; Gettler v. Commissioner, T.C. Memo.1975-87. In both Ray and Houle we denied the deductions on the ground that the taxpayers treated the houses as a "second home" (Ray) or "second residence" (Houle). In Gettler, we denied the deductions, concluding that "the primary purpose in both acquiring the house and holding on to it was to use it as a vacation home." The cited cases stand for the proposition that the holding of a primary or secondary (e.g., vacation) residence motivated in part by an expectation that the property will appreciate in value is insufficient to justify the classification of that property as property "held for investment" under section 212(2) and, by analogy, section 1031.

OPINION

Statements made by or on behalf of the petitioner range from the property not being rented to the property being rarely rented. Nothing in the record indicates that the owners of the property made a realistic attempt to rent the property at fair rental value. Also, the record indicates that the owners did not characterize the property on their income tax returns as being property held for the production of income. If they had, depreciation expenses for the property would have appeared on their income tax return, and it did not. The record is entirely consistent with the property being held for personal use until the attempt to qualify the property for Internal Revenue Code § 1031 treatment. At that point, the contention appears to be that the expenses should have been deducted on Schedule E. Given the lack of effort to rent the property at fair rental value, the activity would be properly characterized as an activity not engaged in for profit pursuant to Internal Revenue Code § 183 with the expenses being denied accordingly. Ray v. Commissioner, *supra*. Accordingly, the property would not qualify for treatment pursuant to Internal Revenue Code § 1031.

The amounts on the Notice of Deficiency Determination were computed based upon the presumption that the petitioner was single. Upon receiving a copy of the petitioner's 2001 federal income tax return, it is clear that [Redacted] filed a joint return with [Redacted]. Accordingly, the liability must be modified to reflect the petitioner's federal filing status.

Additionally, no allowance was made in the Notice of Deficiency Determination to reflect either the basis in the property disposed of or for the Idaho capital gains deduction due to not having sufficient information. The needed information has been furnished. Therefore, these modifications need to be made.

WHEREFORE, the Notice of Deficiency Determination dated May 9, 2007, is hereby MODIFIED and as so modified is APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax, penalty, and interest (computed to June 30, 2008):

| YEAR | TAX | INTEREST | PENALTY | TOTAL |
|---|---|---|---|---|
| 2001 | $862 | $332 | $216 | $1,410 |

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioner's right to appeal this decision is enclosed.

DATED this _____ day of _____, 2008.

IDAHO STATE TAX COMMISSION

_____
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this _____ day of _____, 2008, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted] Receipt No.